

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Chief Financial Officer

Natwar M. Gandhi
Chief Financial Officer



March 29, 2004

The Honorable Anthony A. Williams
Mayor of the District of Columbia
The John A. Wilson Building
1350 Pennsylvania Avenue, N.W., 6th Floor
Washington, D.C. 20004

Dear Mayor Williams:

I am pleased to transmit the Fiscal Year (FY) 2005 Proposed Budget and Financial Plan. The Office of the Chief Financial Officer has worked with the executive leadership team, as well as agency program and budget staff, to address numerous budget issues to produce a balanced budget. We will continue to support this collaborative process as the Council deliberates.

The proposed FY 2005 gross funds operating budget is \$6.25 billion, an increase of \$545.6 million, or 9.6 percent, over the approved FY 2004 gross funds budget of \$5.70 billion. The local funds component of this budget is \$4.17 billion, an increase of \$340 million, or 8.9 percent over the approved FY 2004 local budget of \$3.83 billion. The federal funds component of this budget is \$756.6 million, an increase of \$8.0 million, or 1.1 percent over the approved FY 2004 budget of \$748.6 million. The federal Medicaid payment component of this budget is \$993.1 million, an increase of \$100.8 million, or 11.3 percent over the approved FY 2004 budget of \$892.3 million. The private grant funds component of this budget is \$13.3 million, a decrease of \$453,000, or 3.3 percent from the approved FY 2004 budget of \$13.8 million. The special purpose revenue funds component of this budget is \$309.8 million, an increase of \$65.3 million, or 26.7 percent over the approved FY 2004 budget of \$244.5 million.

The expenditure growth rate for FY 2005 does not set the mold for FY 2006 and beyond. Expenditures are expected to grow at 4.1, 4.6, and 4.3 percent for fiscal years 2006, 2007, and 2008, respectively. It is important to note for these out years that Medicaid is projected to grow at 6 percent annually. It is clear to the District's elected leadership that the FY 2005 local funds expenditure growth of 8.9 percent or \$340 million is not sustainable. The Mayor's FY 2005 Proposed Budget and Financial Plan includes the impact of \$94 million in FY 2004 spending pressures that are recurring in nature. The FY 2005 baseline budget, the starting point for the formulation of the Mayor's proposed budget, includes important budget corrections or increases

to recognize the true cost of providing the current level of services, including entitlements, court order compliance costs, attainable projections of Medicaid reimbursements, and operating costs of completed capital projects. Due to the District's history of experiencing chronic spending pressures, the baseline budget was built on a realistic but not an overly conservative assessment of operating costs. Mayoral enhancements made up 13.4 percent of the FY 2005 expenditure growth.

The Executive branch began the formulation of the proposed budget with a \$249.8 million gap, the difference between baseline revenues and expenditures. Mayoral enhancements of \$45.5 million and baseline budget fixes of \$16.9 million increased the FY 2005 budget gap to \$312.2 million. After a baseline revenue adjustment of \$6.4 million, your office took the following actions to balance the FY 2005 operating budget:

- 1) Drew down \$54.0 million of unreserved fund balance in addition to the \$26.0 million that was already assumed as part of the baseline budget;
- 2) Utilized \$58.8 million of tobacco trust funds;
- 3) Reduced contingency reserve contribution by \$8.3 million, to set aside only the legally minimum level;
- 4) Cut expenditures by \$62.6 million;
- 5) Transferred \$28.1 million of eligible costs to special purpose funds;
- 6) Capped the dedicated revenues of the Housing Production Trust Fund to \$20 million per year, re-directing \$20.5 million to local funds;
- 7) Raised miscellaneous fees, permits and fines to produce additional revenues of \$47.8 million; and
- 8) Raised selected taxes by \$27.4 million.

On a net basis, the Mayoral gap closing actions produced an FY 2005 operating surplus of \$1.7 million.

To balance the remainder of the General Fund five-year financial plan (FYs 2006 through 2008), the proposed budget continues the following through FY 2008:

- A) The annual \$20.0 million cap on Housing Production Trust Fund dedicated revenues;
- B) Maintenance of the enhanced revenues from fees, permits, fines and taxes; and
- C) Utilization of Tobacco Trust Funds for local funds purposes.

In addition, the plan requires the deferral of additional tax parity provisions through FY 2007.

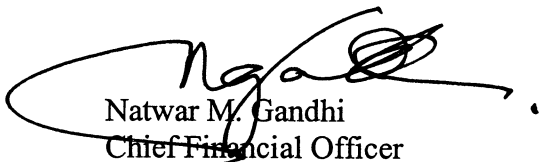
It is precisely these types of actions needed to balance the five-year plan that demonstrate the impact of the District's structural imbalance. As noted by the General Accounting Office, the District has a substantial recurring need for infrastructure improvements and has a disproportionate number of persons living at the federal poverty level that need a wide range of human support and educational services. These factors, combined with high tax rates and a high cost of living, result in a structural imbalance between resources and needs, ranging from \$0.5

billion to \$1.1 billion per year. This problem is particularly evident during economic downturns, when demands for social services are higher, but fewer resources from the District's economically sensitive taxes are available to meet program needs.

This budget also continues our progress in implementing performance-based budgeting (PBB), increasing the total number of agencies transitioned to 57. Under PBB there is a clear relationship between the funding agencies receive, the programs they operate, and the results that they must achieve. Agency narratives have been restructured to better emphasize this relationship. In addition, we have begun the process of developing program benchmarks to supplement the program information in the budget documents. The benchmarks will assist all District officials, as well as the public, to more clearly assess the value of the District's programs and determine where opportunities for improvement exist.

While the District continues to face fiscal challenges, I know that the leadership provided by you and the Council, along with the hard work of the Office of Budget and Planning and others in the Office of the Chief Financial Officer, allowed us to produce a balanced budget for FY 2005. As a result, I am certifying that the FY 2005 Budget and Financial Plan, as proposed, is balanced for FY 2005 and beyond. I look forward to continuing to work with you and the Council during the forthcoming budget deliberations.

Sincerely,



Natwar M. Gandhi
Chief Financial Officer